Supreme Court, U. S.
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IN THE

Supreme Court of The United States

October Term, 1974

No. 74-1611

In the Matter
of
FAS INTERNATIONAL, INC.,
Debtor.

UNITED STATES TRUST COMPANY OF NEW YORK,
Petitioner,

against

FAS INTERNATIONAL, INC., *Debtor,*
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this case on March 25, 1975.

Opinions Below

The Court of Appeals affirmed without opinion the judgment of the District Court for the Southern District of New York. The decision of the Court of Appeals is reported at 511 F. 2d 1164 (2d Cir. 1975). The opinion of the Dis-

trict Court is reported at 382 F.Supp. 77 (S.D.N.Y. 1974) and is printed in Appendix A hereto. The opinion of the Bankruptcy Court below is not reported but is printed in Appendix B hereto.

Jurisdiction

The judgment of the Court of Appeals was entered on March 25, 1975. No rehearing was sought. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Question Presented

Considering that the Trust Indenture Act of 1939 charges indenture trustees with the duty actively to protect the rights of their debenture holders in proceedings under the Bankruptcy Act, but that the Bankruptcy Act does not expressly authorize indenture trustees to be compensated for the performance of that duty in an arrangement proceeding under Chapter XI, does a Bankruptcy Court have the power to award compensation to an indenture trustee and its counsel in a Chapter XI proceeding in which they render valuable services to holders of subordinated debentures who constitute a separate class of creditors and have interests adverse to those of the other unsecured creditors and are otherwise unrepresented?

Statutes Involved

Section 302(a) of the Trust Indenture Act of 1939 (15 U.S.C. § 77bbb(a)):

> Upon the basis of facts disclosed by the reports of the Securities and Exchange Commission made to the Congress pursuant to section 211 of the Securities Exchange Act of 1934 and otherwise disclosed and ascertained, it is hereby declared that *the national public interest and the interest of investors* in notes, bonds, debentures, evidences of indebtedness, and certificates

> of interest or participation therein, which are offered to the public, are adversely affected—
>
> (1) when the obligor fails to provide a trustee to protect and enforce the rights and to represent the interests of such investors. . . [emphasis supplied].

Section 315(c) of the Trust Indenture Act of 1939 (15 U.S.C. § 77ooo(c)):

> The indenture to be qualified shall contain provisions requiring the indenture trustee to exercise in case of default (as such term is defined in such indenture) such of the rights and powers vested in it by such indenture, and to use the same degree of care and skill in their exercise, as a prudent man would exercise or use under the circumstances in the conduct of his own affairs.

Section 339(2) of the Bankruptcy Act (11 U.S.C. § 739(2)):

> A committee [of creditors] elected as provided in section 338 of [Chapter XI] may employ such agents, attorneys, and accountants as may be necessary to assist in the performance of its functions. Expenses of the committee for such assistance, whether incurred before or after the filing of the petition under this chapter, shall be allowed as an expense of administration to the extent deemed reasonable and necessary by the court, provided the arrangement is confirmed. . . .

Section 242 of the Bankruptcy Act (11 U.S.C. § 642):

> The judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in connection with the administration of an estate in a proceeding under [Chapter X] or in connection with a plan approved by the judge, whether or not accepted by creditors and stockholders or finally confirmed by the judge—

(1) by indenture trustees, depositaries, reorganization managers, and committees or representatives of creditors or stockholders;

(2) by any other parties in interest except the Securities and Exchange Commission; and

(3) by the attorneys or agents for any of the foregoing except the Securities and Exchange Commission.

Section 77(c)(12) of the Bankruptcy Act (11 U.S.C. § 205(c)(12)):

Within such maximum limits as are fixed by the Commission, the judge may make an allowance, to be paid out of the debtor's estate, for the actual and reasonable expenses (including reasonable attorney's fees) incurred in connection with the [railroad reorganization] proceedings and plan by parties in interest and by reorganization managers and committees or other representatives of creditors and stockholders, and within such limits may make an allowance to be paid out of the debtor's estate for the actual and reasonable expenses incurred in connection with the proceedings and plan and reasonable compensation for services in connection therewith by trustees under indentures, depositaries and such assistants as the Commission with the approval of the judge may especially employ.

Statement of the Case

FAS International, Inc. ("FAS"), filed a petition for arrangement under Chapter XI of the Bankruptcy Act on February 8, 1972 and thereafter proposed a plan of arrangement (the "Plan") which was ultimately confirmed. One of the classes of creditors included in the Plan consisted of the more than 500 holders of $16,500,000 of 5% Convertible Subordinated Debentures due 1989 which FAS had issued to the public in 1969 pursuant to an indenture qualified under the Trust Indenture Act of 1939. The holders of the debentures were represented immediately prior

to and during the Chapter XI proceeding by the petitioner (the "Trust Company"), which had become the successor indenture trustee upon the resignation of the original trustee. Following confirmation of the Plan, the Trust Company and its counsel applied to the Bankruptcy Court for allowances for services performed by them in the course of the proceeding.* The Bankruptcy Court denied the applications; its decision was affirmed by the District Court and by the Court of Appeals. It is the latter judgment which the Trust Company seeks to have reviewed by this Court.

At the time of the filing of the Chapter XI petition FAS's unsecured creditors consisted of banks, trade creditors and the debenture holders. Immediately after the filing of the petition FAS held meetings with representatives of the bank consortium and the trade creditors. The Trust Company and its counsel were not invited to attend such meetings, nor did FAS seek to meet independently with the Trust Company or any other representative of the debenture holders. FAS and the other creditors took the position that the debenture holders were precluded from any recovery by provisions in the indenture which made the debentures subordinate in right of payment to the prior payment in full of FAS's bank debt.

The Trust Company then solicited proofs of claim from the debenture holders with powers of attorney to vote such claims in favor of a committee that would be representative of all classes of creditors, including the debenture holders. At the first meeting of creditors, the Trust Company attempted to vote the separate claims of 400 debenture holders as well as its unitary claim as indenture trustee on behalf of the rest of the debenture holders. The Bankruptcy Court ruled that the Trust Company could vote only a

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* In Section 8.06 of the indenture, FAS had agreed to pay the trustee reasonable compensation (including reimbursement for the reasonable fees and expenses of its counsel) for all services rendered by it in the exercise and performance of its powers and duties under the indenture.

single claim on behalf of all debenture holders and thereupon declared the other creditors' nominees, not including any representative of the debenture holders, elected as the official creditors' committee. The Trust Company thereupon filed notice that it would appeal the Bankruptcy Court's ruling to the District Court.

Notwithstanding the debenture holders' disenfranchisement, the Trust Company's announced intention to appeal the Bankruptcy Court's decision, coupled with its counsel's argument that the subordination provisions of the indenture were inapplicable, combined to bring the Trust Company and its counsel into the negotiations between FAS and the official creditors' committee with respect to a plan of arrangement.

The financial condition of FAS dictated that a plan provide for the unsecured creditors to accept FAS stock in full satisfaction of their claims. The principal matter for negotiation, therefore, was the allocation of such shares among the various classes of creditors. It was generally conceded that the Trust Company had raised valid questions about the scope and extent of the subordination of the debentures and that it would be impractical to attempt to confirm a plan which excluded the debenture holders, because of the virtual certainty of an appeal from the order confirming any such plan.

These negotiations ultimately culminated in agreement on the terms of the Plan, which provided for the "subordinated" debenture holders to receive a substantial amount of FAS common stock and for an officer of the Trust Company to be elected as one of five FAS directors. As a result, the debenture holders became the owners of approximately 20% of the outstanding stock of FAS. The debenture holders thus realized a substantial benefit from the active part taken by the Trust Company and its counsel in these negotiations.

After confirmation of the Plan, the Trust Company and its counsel filed applications for allowances (5a, 11a).* The applications described the extensive amount of work performed before and after agreement on the Plan, including the Trust Company's solicitation of consents of debenture holders to the Plan. No objections to the applications were raised by any party.

The Bankruptcy Court, "lauding the conduct and the quality of the services" performed by the Trust Company and its counsel, stated:

> I also think I need do no more than comment on the indenture [trustee's] sterling services rendered for the beneficiaries of the trust—the subordinate debenture holders. I am willing to accept as a finding of ultimate fact that it was by reason of the services by the attorneys for the indenture trustee and by that trustee [itself] which resulted in inclusion of that class of creditors in the debtor's arrangement proposals. Certainly the debtor need not have accommodated subordinate debt inasmuch as the primary debt was not being accommodated in full. See *In re Itemlab, Inc.*, 197 F.Supp. 194 (E.D.N.Y. 1961). Similarly, it may be assumed that the indenture trustee performed fine services for the class in keeping with the duties imposed on indenture trustees.

Nevertheless, the Bankruptcy Court denied the applications on the ground that it lacked both the statutory authority and the equitable power to award an allowance for such services in a Chapter XI proceeding. Pointing out that Section 339(2) of the Bankruptcy Act did not specifically include indenture trustees among those entitled to compensation from the debtor's estate, the Court concluded that "the policy of the Bankruptcy Act is against compensation unless expressly provided for," citing *Lane* v. *Haytian Corporation of America*, 117 F.2d 216, 219 (2d Cir. 1941), *cert. denied*, 313 U.S. 580 (1941) for this proposition.

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* Citations with the suffix "a" are to pages of the Appendix filed with the Court of Appeals, a certified copy of which has been filed in this Court.

The District Court affirmed, agreeing with the Bankruptcy Court that the omission of indenture trustees from the statute's enumeration of those entitled to compensation was "unambiguous" and did not appear to have been a product of legislative oversight. The District Court recognized that the divergence of interests between the debenture holders and other creditors justified the work performed by the Trust Company and gave rise to an equitable ground for the trustee's compensation. However, after reviewing the changes in Section 339(2) which had been enacted since the *Lane* case was decided, the District Court inferred that Congress had scrutinized the situation regarding compensation and reimbursement in Chapter XI proceedings and had seen fit to leave "undisturbed" the omission of a specific provision covering compensation of indenture trustees. In such circumstances, the Court decided, a bankruptcy court was prevented from utilizing its equity powers to award compensation. If indenture trustees are to receive allowances, in the District Court's view, corrective legislation is required.

The Court of Appeals affirmed the District Court's judgment, without opinion, "for the reasons stated" in the opinion of the District Court.

Reasons for Granting the Writ

The judgment of the Court of Appeals in this case, if permitted to stand, will rob the Trust Indenture Act of 1939 of its vitality in the one area where the holders of publicly-issued debt securities most need that Act's protection: Chapter XI arrangements. In denying the power of a bankruptcy court in a Chapter XI proceeding to compensate an indenture trustee and its counsel, the courts below have failed to take into account the disastrous consequences which their decision heralds for the countless numbers of public investors who look to indenture trustees for the protection of their rights. The public policy so clearly enunciated by the Congress in Section 302(a) of the

Trust Indenture Act, *supra*, has been ignored. It is essential that this Court, which has never before addressed itself to the question presented by this case, review the judgment of the Court of Appeals in order to insure that these vital policy considerations be given proper weight.

I.

To Congress, the services rendered by indenture trustees were of such importance to "the national public interest and the interest of investors" as to warrant the passage of special legislation, the Trust Indenture Act, which sets forth standards with respect to the performance of those services. The Trust Indenture Act in effect requires, and the FAS indenture provided, that when the obligor seeks relief under the Bankruptcy Act (or the indenture securities are otherwise in default) the trustee must exercise the powers vested in it by the indenture with "the same degree of care and skill . . . as a prudent man would exercise or use under the circumstances in the conduct of his own affairs." Trust Indenture Act § 315(c), *supra*. The investors' assurance that this standard of performance will be adhered to is surely one of the most valuable achievements mandated by the Congress in the Trust Indenture Act.

Without an indenture trustee to represent them, the holders of bonds and debentures are, in many instances, denied any practical opportunity of protecting their interests in proceedings under Chapter XI of the Bankruptcy Act. In contrast to Chapter X and Section 77 reorganizations, the arrangement procedure provided in Chapter XI was not created with the view that it would apply to large companies with complicated financial structures. Since its enactment, however, Chapter XI has proved to be a flexible and highly useful tool for the reorganization of relatively small publicly-owned companies and is now utilized by many such companies with debenture issues in the hands of the public. Chapter XI arrangements are generally far less

costly and more expeditious than Chapter X reorganizations. Moreover, they are not subject to the "absolute priority rule" which governs in Chapter X and makes that chapter significantly less advantageous to the holders of subordinated debt securities. Without the services rendered by their indenture trustees, however, debenture holders would, for the most part, go unrepresented in a Chapter XI proceeding. Unlike Chapter X, Chapter XI makes no provision in its statutory scheme for the Securities and Exchange Commission to intervene on behalf of the interests of public investors. Thus, where such interests are adverse to those of the other creditors (as in this case), the indenture trustee is likely to be the only protection many thousands of small investors have.

II.

There is no evidence that Congress intended indenture trustees to perform these vital duties without compensation. On the contrary, to assure the continued and effective service of indenture trustees, Congress has expressly directed the courts to compensate indenture trustees for the services they render in reorganization proceedings and to reimburse them for their expenses. In a Chapter X reorganization, the judge may "allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in connection with the administration of an estate . . . by the indenture trustee. . . . ." Bankruptcy Act §242, *supra*. Similarly, §77 of the Bankruptcy Act, providing for the reorganization of railroads, permits the judge to "make an allowance to be paid out of the debtor's estate for the actual and reasonable expenses incurred in connection with the proceeding and reasonable compensation for services in connection therewith by trustees under indentures. . . ." Bankruptcy Act §77(c)(12), *supra*. Clearly Congress realized, when it enacted Chapter X and Section 77, that publicly-held debt securities would be involved and would have to be protected. Thus it made certain that indenture trustees

in those proceedings would be compensated for their efforts on behalf of the holders of those debt securities.

The absence of express language authorizing the payment of allowances to indenture trustees in Chapter XI proceedings does not compel the conclusion, reached below, that Congress was prohibiting the courts from making such awards. Nothing in the Court of Appeal's opinion in *Lane* v. *Haytian Corporation of America, supra,* can be read as leading toward such a conclusion because neither the compensation of the indenture trustee nor the policy considerations underlying the Trust Indenture Act were in issue there. (*Lane* held that no allowance can be granted to an unofficial committee of creditors in a Chapter XI proceeding where the creditor body as a whole is adequately represented by the official committee. The extent to which the court below erred by applying the *Lane* holding to this case can most easily be illustrated by the fact that in the confirmed plan of arrangement which was the subject of the *Lane* case *the attorneys for the indenture trustee were in fact awarded compensation.* 117 F. 2d at 217.) On the contrary, the acts of Congress regulating proceedings in which indenture trustees could have been expected to participate suggest precisely the opposite conclusion: that an indenture trustee and its counsel should be compensated wherever called upon to act in bankruptcy proceedings. As noted, Congress has determined that an indenture trustee shall be awarded reasonable compensation for services rendered, and reimbursement for the reasonable expenses incurred, on behalf of its security holders in Chapter X and § 77 proceedings. For Congress knowingly to have directed that indenture trustees be compensated for carrying out their special responsibilities in proceedings conducted under the rubric of Chapter X or § 77, but not Chapter XI, would be so anomalous as to be nearly unthinkable. For such responsibilities to be imposed by Congress on an indenture trustee without allowing it just compensation would contravene basic principles of fairness and equity.

III.

The grave consequences of the ruling below, if it is allowed to stand, were accurately described in the *amici curiae* brief filed with the Court of Appeals on behalf of seven leading New York City banks and trust companies, each of which acts as trustee under many indentures protecting the holders of billions of dollars worth of bonds and debentures. Most indentures provide that the trustee is absolved of all liability in refusing to act where it appears it will not be adequately reimbursed for the expenditure of funds in performing its tasks.* Consequently, a holding that a Chapter XI court has no power, regardless of the circumstances, to reimburse an indenture trustee for its expenses would appear to relieve the indenture trustee of the responsibility to participate on behalf of debenture holders in a Chapter XI proceeding, thereby leaving public debenture holders without effective representation. In that event, the only alternative may be to amend the Chapter XI petition to comply with the requirements of Chapter X and continue the proceeding under the latter chapter, Bankruptcy Act § 328, 11 U.S.C. § 728, where compensation and reimbursement are available. In the generality of cases, and in all cases where the public debt is subordinated, such action, while enabling compensation to be paid to the indenture trustee and its counsel, would be to the economic detriment of the debenture holders.

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* For example, Section 601(c)(4) of the Model Debenture Indenture Provisions of the Corporate Debt Financing Project of the American Bar Foundation (1965), provides:

> (4) no provision of this Indenture shall require the Trustee to expend or risk its own funds or otherwise incur any financial liability in the performance of any of its duties hereunder, or in the exercise of any of its rights or powers, if it shall have reasonable grounds for believing that repayment of such funds or adequate indemnity against such risk or liability is not reasonably assured to it.

This provision was incorporated in Section 8.01 of the FAS indenture.

The courts have a Congressional mandate to protect the public holders of securities by awarding compensation to indenture trustees in all proceedings where it was believed such publicly-held securities would be involved. The services performed by indenture trustees in Chapter XI cases are of the same order as those rendered in other rehabilitative proceedings under the Bankruptcy Act. The beneficial role played by indenture trustees should not be foiled by a misreading of Congressional intent with respect to Chapter XI. This Court should encourage the salutary evolution of Chapter XI by correcting the decision below and holding that a Chapter XI court has the power to grant allowances to an indenture trustee and its counsel under circumstances such as are presented in this case.

Conclusion

For the foregoing reasons, it is respectfully urged that this petition for a writ of certiorari be granted.

Respectfully submitted,

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Appendix A

Opinion of the District Court

IN THE MATTER OF

FAS INTERNATIONAL, INC.,
Debtor.

No. 72 B 128-139

UNITED STATES DISTRICT COURT,
SOUTHERN DISTRICT OF NEW YORK

August 26, 1974

GURFEIN, District Judge:

The United States Trust Company of New York ("U.S. Trust"), indenture trustee for $16,500,000 of 5% subordinated convertible debentures of the Debtor, and its counsel, Whitman & Ransom, appeal from an order of Referee (now Bankruptcy Judge) Roy Babitt denying them allowances upon the confirmation of an arrangement under Chapter XI of the Bankruptcy Act (11 U.S.C. § 701 et seq.). Judge Babitt in a memorandum opinion denied the allowances upon the ground that the Bankruptcy Act made no statutory provision for such allowances in a Chapter XI proceeding and that the Bankruptcy Court could not, under its equity power, enlarge upon the statute. The appellants contend that the question is one of first impression.[1]

The facts are somewhat unusual. U. S. Trust was the Successor Indenture Trustee of the subordinated debenture issue described above. The Debtor filed a petition for an arrangement under Chapter XI on February 8, 1972. In addition to the unsecured subordinated debenture holders

1. A brief was filed on behalf of interested banks and trust companies as *amici curiae*.

there were also unsecured bank creditors and unsecured trade creditors.

Shortly before filing the petition and immediately thereafter the Debtor negotiated with the consortium of bank creditors and with the trade creditors but not with the Indenture Trustee. The Debtor and the other creditors apparently took the position that since the debentures were "subordinated" debt, their holders could have no voice in the negotiation of a settlement.

Appellant nevertheless sought proofs of claim from the debenture holders and attempted to vote the election of an official creditors' committee which would include debenture holders, and for the election of an officer of appellant as tentative trustee. In the meantime it had retained the services of Whitman & Ransom, the other appellant, as its attorney on behalf of the debenture holders.

The first meeting of creditors was held on March 14, 1972. The attempt of appellant to vote its proofs of claim was resisted. The question of the right to vote the proofs of claim under Section 338 of the Act, 11 U.S.C. § 738, was submitted to the Referee who held that the debenture holders in the aggregate could vote only one claim. This, in effect, disenfranchised the public debt from separate representation on the official committee. An appeal from this ruling was not perfected.

Counsel for the Indenture Trustee was not without resources, however. Although the indenture provided for the assignment of the subordinated debt to the senior indebtedness in the event of insolvency of the debtor, he came up with the contention that, because of certain ambiguities of language in the indenture, the "subordinated" debentures might not be subordinate in an arrangement that contemplated the acceptance of common stock by the bank creditors. Suffice it to say that the argument of the Indenture Trustee prevailed to the extent that the "subordinated" debenture holders were recognized as a class which had not been wiped out because of the failure to make whole the creditors with priority.

Normally, subordinate debt is deemed worthless if the primary debt is not satisfied in full. See *In re Itemlab, Inc.*, 197 F.Supp. 194 (E.D.N.Y.1961). By virtue of their argument that they were not in fact "subordinate," the debenture holders were taken into the negotiations and emerged with a part of the rehabilitated company for their own. The negotiations had taken place before the time to file a petition for review of the Referee's rule had expired, and were conducted under threat by the debenture holders that they would pursue the appeal. An agreement was reached that the appellant would withdraw its petition for review and that the Plan would provide that the debenture holders would receive in the aggregate 196,092 shares of the common stock of the Debtor, representing about 20% of the stock of the Debtor to be outstanding after confirmation.

All unsecured creditors received stock and no cash. The Plan also provided for the election of an officer of the appellant as one of five directors.

Appellant further asserts that the legal fees incurred by the appellant were to be paid by the Debtor subject to the approval of the Bankruptcy Court. Counsel for the Debtor denies that any such agreement "oral or written" was ever made. No writing has been tendered in support of the alleged agreement.[2]

In the fixing of allowances the Referee denied the applications of the Indenture Trustee and of its counsel for lack of statutory authority or equitable power. Both the Trustee and counsel brought this petition for review. The order of the Referee is confirmed.

The Court of Appeals for this circuit has enunciated the rule that "the bankruptcy court lacks power to grant, and the policy of the Act is against, compensation not expressly

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2. There is no need to find whether a "firm engagement" was undertaken, for a debtor may not bind itself to pay for the services of committees other than the official committee. *Lane* v. *Haytian Corp.*, *infra*.

provided for by the Act." *Lane* v. *Haytian Corp.*, 117 F.2d 216, 219, (2 Cir. 1941) *cert. denied*, 313 U.S. 580, 61 S.Ct. 1101, 85 L.Ed. 1537 (1941); see also *Guerin* v. *Weil, Gotshal & Manges*, 205 F.2d 302 (2 Cir. 1953). This rule was expressed in a proceeding for an arrangement in a Chapter XI proceeding. Unless *Haytian* has been eroded in this respect, the search must be limited to whether compensation is expressly granted under the Act.[3] Appellants concede it is not, but they argue that the Bankruptcy Court may, nevertheless, award compensation upon principles of equity. This requires a brief review of the provisions of Chapter XI and an inquiry into whether Congress intended to foreclose allowances to all except the official committee.

Section 338 of the Act provides for the election of an official committee of creditors to represent the interests of all unsecured creditors. Under Section 337(2) the Court fixes a time when the debtor is required to deposit "the actual and necessary expenses incurred . . . by the committee of creditors and the attorneys or agents of such committee." As Judge Clark noted in *Haytian, supra*, these references are to a *single* committee. 117 F.2d at 219.[4] Section 339(2) of the Act provides for the payment of expenses of such a committee and the fees of its counsel. The Act does not provide for the reimbursement of expenses or the payment of legal fees to any other person or body representing creditors in Chapter XI proceedings.[5]

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3. *Haytian* was overruled in 1952 by an amendment to Section 337(2) and Section 338 to the extent that the *Haytian* court had barred payment to an unofficial committee for services rendered before the arrangement. See 8 Collier, Bankruptcy § 5.34 n. 39; *In re Casco Fashions, Inc.*, 490 F.2d 1197, 1202-1203 (2 Cir. 1973).

4. While there have been amendments since 1941, they do not touch upon this point.

5. I am aware that the Second Circuit has recently applied Section 62 as authority for an allowance of fees to the attorneys for a debtor in possession in an *abortive* Chapter XI proceeding in a subsequent bankruptcy. In *re Casco Fashions, Inc., supra*. Cf. *Robinson, Wolas & Hagen* v. *Gardner*, 433 F.2d 1104 (9 Cir. 1970). I think that where the arrangement has been confirmed, the statutory limitations in Chapter XI itself apply.

Appellants recognize that an Indenture Trustee was denied an allowance in a Chapter XI proceeding by our late brother McLean in *Matter of Straus-Duparquet, Inc.*, (unreported), No. 65 B 181 (S.D.N.Y. May 10, 1966), but they contend that the case is not analogous for the reason that the Indenture Trustee in *Straus* represented debenture holders who were not subordinated and hence ranked *pari passu* with other unsecured creditors. The inference is that the Indenture Trustee in *Straus* duplicated the work of the official committee because there was no conflict of interest between the debenture holders and the other unsecured creditors. *Per contra* it is suggested that, in view of the position of the debenture holders here as adverse to the other unsecured creditors, the official committee could not adequately represent them and, hence, they were entitled to separate representation in passing upon the adequacy of the Plan.

In addition to this equitable argument, the appellants suggest, and the *amici curiae* stress, that indenture trustees are generally not required under the indenture to provide legal services unless cash is advanced by the debenture holders,[6] and hence disallowance of expenses to the trustee will result either in inaction to the detriment of the debenture holders or pressure to move the arrangement into a Chapter X reorganization where expenses can be reimbursed and compensation allowed.

The argument really comes down to this. Since compensation is allowed to an indenture trustee in a Chapter X reorganization (Section 242 of the Act, 11 U.S.C. § 642), (and in a railroad reorganization (Section 77[c][12] of the Act, 11 U.S.C. § 205[c][12])), in a particular arrangement, as here, which happens to be appropriate for a Chapter X proceeding as well as a Chapter XI arrangement, it ought to be recognized that compensation should in equity be allowed in Chapter XI just as it is allowed in Chapter X.

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6. See Model Debenture Indenture Provisions of the Corporate Debt Financing Project of the American Bar Foundation, Section 601(c)(4).

The argument is appealing but it brings into focus the relative functions of Congress and the Courts. I would assume that, despite the rule laid down in *Haytian,* if it appeared that Congress had overlooked a situation in Chapter XI which was precisely the same as it provided for in Chapter X, a court of equity, which the Bankruptcy Court is, *Bank of Marin* v. *England,* 385 U.S. 99, 103, 87 S.Ct. 274, 17 L.Ed.2d 197 (1966), might supply the ommission.

The difficulty with that solution is twofold. First, although it is strange that Chapter XI, which was supposed to take care of cases that were relatively simple, has now come to include, as a matter of course, arrangements where there is unsecured public debt, Congress has seen fit to leave the situation respecting compensation and reimbursement undisturbed. Petitions may be brought by the Securities and Exchange Commission or a party to move the proceeding into Chapter X. Section 328 of the Act, 11 U.S.C. § 728. If that is not done or refused by the Court, the debtor with an oustanding unsecured public issue can remain in Chapter XI.

Congress assumed, moreover, in enacting Chapter XI that there might be separate classes of creditors, for it provided that "the court may fix the division of creditors into classes and, in the event of controversy, the court shall after hearing upon notice summarily determine such controversy." Section 351 of the Act, 11 U.S.C. § 751. The assumption is that there might be controversy among creditors serious enough to require adjudication.

In spite of this recognition, the Act provides, as we have seen, for only a single committee, as distinguished from "committees" in Chapter X. (Section 242 of the Act, 11 U.S.C. § 642); *Lane* v. *Haytian Corp., supra,* 117 F.2d at 219. This assumes that conflicting interests would be subsumed under a single committee which is charged with representing "the creditors" without exception. Section 339 of the Act, 11 U.S.C. § 739. The failure to provide reimbursement and compensation to others than the official committee does not appear to have been an oversight. If a

conflict of interest among creditors is enough to found separate claims for compensation to their respective representatives, the Act should be amended so to provide.

Second, so far as the equity power of the court is concerned, it is still doctrine that expenses and allowances by the Bankruptcy Court shall be limited to statutory allowances. Appellants have cited no case, except a bankruptcy referee's decision in the Eastern District, *In Matter of Fotochrome, Inc.,* D.C. 346 F.Supp. 958 (1972), where the conceded equity powers of the Bankruptcy Court have been used to award compensation without a statutory basis in a Chapter XI proceeding.[7] I agree with Judge Babitt that since Congress has decided who may be reimbursed and compensated, an equity court may not enlarge upon legislation which is both an expression of policy and unambiguous.

Even if an equity court should wish to venture into the legislative domain, it would be faced with problems. Is every indenture trustee entitled to compensation from the debtor's assets even though its debenture holders rank on a par with the other creditors? Is an indenture trustee who represents truly subordinated debenture holders entitled to compensation where the primary debt cannot be paid in full? Is a special case made where the debentures though in form subordinated contend that they are entitled to rank with primary debt? If allowances may be made to indenture trustees in Chapter XI, may they also be made to more than one committee of unsecured creditors as in Chapter X? The answers to these and similar questions are of the very essence of the legislative process. I believe they should not be determined by a court as part of its equity jurisdiction, since they involve policy questions within the framework of an integrated legislative scheme.

On petition for review, the decision of the Bankruptcy Judge is confirmed.

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7. Judge Friendly in *In re Casco Fashions, Inc., supra,* relied primarily on a statutory provision, Section 62, (11 U.S.C. § 102) to allow fees, *in a subsequent liquidation bankruptcy,* to attorneys for the debtor in possession in the aborted Chapter XI arrangement.

Appendix B

Opinion of the Bankruptcy Court

IN THE MATTER OF

FAS INTERNATIONAL, INC.,
Debtor.

No. 72 B 128-139

UNITED STATES DISTRICT COURT,
SOUTHERN DISTRICT NEW YORK

September 25, 1973

MEMORANDUM OPINION ON ALLOWANCES

BABITT, Referee:

By separate opinion, the Court has fixed the allowances of those held by the statutory scheme of Chapter XI, Sections 301 *et seq.* of the Bankruptcy Act, 11 U.S.C. §§ 701 *et seq.*, to be entitled compensation for services rendered in this now confirmed Chapter XI. Inasmuch as the Court has concluded that the application by Whitman and Ransom, as attorneys for the United States Trust Company of New York as an indenture trustee, and that by the indenture trustee for separate compensation must be denied for want of statutory authority or equitable power to pay compensation from a debtor's estate, this separate opinion is necessary.

I need do no more than make passing reference to the decision rendered in the earlier days in these proceedings to the effect that subordinated debenture holders were disfranchised [*sic*] from voting for the election of an official creditors' committee under Section 338 of the Act, 11 U.S.C. § 738, and which decision became final without appeal. I also think I need do no more than comment on the indenture trustee's [*sic*] sterling services rendered for the beneficiaries of the trust—the subordinate debenture holders. I am willing to accept as a finding of ultimate fact that it was by reason of the services by the attorneys for the indenture trustee and by that trustee himself which resulted in inclusion of that class of creditors in the debtor's arrangement proposals. Certainly the debtor need not have accommodated subordinate debt inasmuch as the primary debt was not being accommodated in full. See *In re Itemlab, Inc.*, 197 F. Supp. 194 (E.D.N.Y. 1961). Similarly, it may be assumed that the indenture trustee performed fine services for the class in keeping with the duties imposed on indenture trustees.

Accepting all of the allegations of the applications as truthful and lauding the conduct and quality of the services to the class of both counsel and the indenture trustee, I am of the view that there is no support in the Bankruptcy Act for compensation in the circumstances here present.

It is no longer open to doubt that the bankruptcy court lacks the power and the policy of the Bankruptcy Act is against compensation unless expressly provided for. *Lane* v. *Haytian Corp. of America*, 117 F.2d [216] (2d Cir. 1941), cert. denied 313 U.S. 580 (1941). Nor was that policy altered by any of the various amendments to the Bankruptcy Act which followed in the wake of *Lane* v. *Haytian Corp., supra.* Neither the 1952 amendment nor its 1967 progeny event remotely suggests that a struggling debtor is to be saddled with bearing the expenses of informal groups or classes of creditors. Nor can the indenture trustee prevail by an appeal to the broad equity power of the bankruptcy court, noted, *inter alia,* in *Bank of Marin* v. *England,* 389 U.S. 99

(1966) at 103. See *In Re Max Fishman Inc.,* 27 F. Supp. 33 (S.D.N.Y. 1939). The relief sought here cuts so deeply against the grain of the policy of the Act that not even an appeal to an equitable conscience can allow it. Congress' efforts to overcome the restricted holding of *Lane* v. *Haytian Corp., supra,* in one amendment in 1952 and then in another in 1967, designed to overcome the weakness of the first, House Report No. 121, 90th Cong., 1st Sess. (1967), are clearly shown by the language Congress used.

The plain broad language of Section 339 must be given the plain meaning the words spontaneously yield. Those entitled to seek compensation for service to the debtor's creditors are strictly defined. The fact is that Section 339 of the Act contemplates services and compensation only to an official committee of creditors as provided for by Section 338, 11 U.S.C. § 738; and the compensation for such agents, attorneys, and accountants as may be necessary to assist that committee in the discharge of its functions as set forth by subdivision (1) of Section 339 is authorized only in the event of a successful arrangement proceeding, i.e., only if the debtor's proposal is confirmed. That statute as it has evolved from at least two examinations by Congress in recent years expresses the limits to which Congress was willing to go.

In the absence of express authority in the statute the policy of the Bankruptcy Act dictates disallowance of those not clearly entitled to compensation.

The fact of the matter is that the indenture trustee and his attorney labored exclusively for their beneficiaries—the debenture holders. Compensation to the attorneys of the trustee should come from the trustee. This is no different than the treatment given any attorney representing a creditor as his own client. It is to that client that counsel must look for compensation. It is clear that the interests of the indenture trustee and the beneficiaries ran counter to the interests of this debtor. To direct a debtor to compensate those who served their own clients in a cause antithetical to

the debtor's would subvert the rehabilitative purposes of Chapter XI. Congress would have to speak much more directly to broaden the coverage given to the official creditors' committee.

The applications are both refused. It is so ordered.

Supreme Court, U. S.
FILED
JUL 23 1975
MICHAEL RODAK, JR., CLERK

In The

Supreme Court of the United States

October Term, 1974

No. 74-1611

In the Matter
of
FAS INTERNATIONAL, INC.,
Debtor.

UNITED STATES TRUST COMPANY OF NEW YORK,
Petitioner,

—against—

FAS INTERNATIONAL, INC.,
Debtor-Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Statutes:

Trust Indenture Act of 1939

Section 311; 15 U.S.C. §77kkk	2, 4, A-1
Section 317; 15 U.S.C. §77qqq	2, 4, A-3

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FAS INTERNATIONAL, INC.,

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UNITED STATES TRUST COMPANY OF NEW YORK,

Petitioner,

–against–

FAS INTERNATIONAL, INC.,

Debtor-Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Respondent prays that Petitioner's petition for a writ of certiorari to issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this case on March 25, 1975, be denied.

Opinions Below

The Court of Appeals affirmed without opinion the judgment of the District Court for the Southern District of New York. The decision of the Court of Appeals is reported at 511 F.2d 1164 (2d Cir. 1975). The opinion of the District Court

is reported at 382 F. Supp. 77 (S.D.N.Y. 1974) and is printed in Appendix A of the petition herein. The opinion of the Bankruptcy Court below is not reported but is printed in Appendix B of the petition herein.

Jurisdiction

The Respondent makes no challenge to the jurisdiction of this Court.

Question Presented

The question presented for review is whether or not the Bankruptcy Court has the power and the authority to award compensation to an indenture trustee in a proceeding for an Arrangement pursuant to Chapter XI of the Bankruptcy Act, particularly where the indenture trustee's services only benefited debentureholders and did not benefit the estate, and in light of the fact that, in enacting the Bankruptcy Act as amended, Congress has excluded indenture trustees from the list of persons eligible for such compensation in Chapter XI proceedings.

Statutes Involved

Respondent would add to the statutes cited by petitioner the following:

Those portions of Section 311 of the Trust Indenture Act of 1939 (15 U.S.C. §77kkk) reproduced as Appendix A hereof.

Those portions of Section 317 of the Trust Indenture Act of 1939 (15 U.S.C. §77qqq) reproduced as Appendix B hereof.

Statement of the Case

Respondent agrees with petitioner's Statement of the Case, except:

1. The debentureholders were not disenfranchised as petitioner contends at Page 6 of the petition.

2. Respondent denies that "It was generally conceded. . . ."

that petitioner had raised valid questions about the scope and extent of the subordination of the debentures as petitioner asserts at Page 6 of the petition.

3. Respondent adds and emphasizes that the services rendered by petitioner were of benefit only to the subordinated debentureholders it represented and were of no benefit to the debtor's estate.

ARGUMENT

Reasons for not granting the writ of certiorari prayed for are that the decisions below are entirely consistent with the provisions and intent of the Trust Indenture Act of 1939 as well as those of the Bankruptcy Act. In addition, as is pointed out in the District Court opinion and affirmed by the Court of Appeals, the question raised by the petitioner properly is a subject for legislative, not judicial, review.

I

Petitioner argues that Indenture Trustees perform important services in Chapter XI arrangement proceedings, that they are required to do so by the terms of the Trust Indenture Act of 1939 and that Congress could not have intended that they perform such services without compensation.

Petitioner misses the point. The question is not whether indenture trustees perform useful services in Chapter XI arrangement proceedings or whether they are required to do so, nor is it whether indenture trustees should be compensated for performing such services. The question is: has the Bankruptcy Court the power and authority to authorize and require the debtor in a proceeding for an arrangement pursuant to Chapter XI of the Bankruptcy Act to pay an indenture trustee compensation and expenses as an expense of administration, particularly where the services rendered by the indenture trustee benefited only the debentureholders it represented and were of no benefit to the debtor's estate. The answer clearly is no.

Petitioner cites certain sections of the Trust Indenture Act of 1939 to support the proposition that indenture trustees are required to perform certain services in Chapter XI proceedings and therefore are entitled to compensation.

Petitioner overlooks, however, Section 317 of the Trust Indenture Act of 1939, reproduced in part as Appendix B hereto, which expressly and without limitation authorizes debenture trustees to file proofs of claim on their behalf as well as on behalf of securities holders in any judicial proceeding. Petitioner also overlooks those provisions contained in Section 311 of the Trust Indenture Act of 1939, reproduced in part as Appendix A hereof, which *inter alia* provide an indenture trustee with a preferred status in collecting upon its claim against an obligor upon the obligor's failure to make full payment of principal or interest when and as the same becomes due. The same section provides at subsection (b)* that the Indenture may (but need not) exclude the indenture trustee's compensation and expenses from the operations of the provisions summarized above.

It has been noted, in the oral argument before the Court of Appeals, that the Indenture herein provided that FAS International, Inc. (FAS) would compensate the indenture trustee and pay its expenses. Further, it was suggested that the Trust Indenture was a contract entered into before FAS filed its petition for an arrangement pursuant to Chapter XI of the Bankruptcy Act and that the indenture trustee's proper recourse in seeking compensation and expenses for carrying out its obligations pursuant to that contract was to file a proof of claim in the Chapter XI proceedings for an unliquidated amount as a general unsecured creditor. To do so would have been consistent with the Trust Indenture Act of 1939 as well as with Chapter XI of the Bankruptcy Act and the opinions below which petitioner would have this Court review. To do so also would have achieved an equitable result since the indenture trustee would have received shares of stock of the debtor corporation. The indenture trustee's "valuable" services to the debentureholders resulted in their receiving shares of stock of the debtor corporation – a benefit not accruing to the estate herein.

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* Appendix A at Page A-2.

II

Petitioner argues in its petition, as it did in the courts below, that because Chapter X of the Bankruptcy Act expressly authorizes compensation of indenture trustees, as an expense of administration, the same treatment should be afforded in proceedings pursuant to Chapter XI of the Bankruptcy Act.[1] Chapter XI of the Bankruptcy Act excludes indenture trustees from the list of persons who are to receive such treatment just as purposefully as Chapter X includes them. Throughout numerous revisions of the Bankruptcy Act, Congress consistently has excluded indenture trustees from the list of those entitled to be compensated as an expense of administration in Chapter XI arrangement proceedings. Clearly, the courts below were correct in holding that it is the province of Congress, not the Courts, to write indenture trustees into the list of persons entitled to receive compensation and expenses as an expense of administration in Chapter XI proceedings.

CONCLUSION

For the foregoing reasons, it is respectfully urged that the within petition for a writ of certiorari should be denied because petitioner has proffered no substantial reasons for granting such a writ.

Respectfully submitted,

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Of *Counsel:*
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1. It should be noted that even in Chapter X proceedings Indenture Trustees are not entitled to receive compensation and expenses as an expense of administration when, as here, their activities benefit only the debentureholders and are of no benefit to the estate. *In re Prudence Bonds*, 122 F.2d 258 (C.C.A. 2d 1941); *In re Philadelphia & Reading Coal & Iron Co.*, 61 F. Supp. 120 (E.D.Pa., 1945).

Concurrence of Attorneys for
Creditors Committee

Counsel for the official committee of creditors concurs with the debtor-respondent on its brief.

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APPENDIX A

Trust Indenture Act of 1939, Section 311 (15 U.S.C. §77 kkk)

Preferential collection of claims against obligor

(a) Subject to the provisions of subsection (b) of this section, the indenture to be qualified shall provide that if the indenture trustee shall be, or shall become, a creditor, directly or indirectly, secured or unsecured, of an obligor upon the indenture securities, within four months prior to a default as defined in the last paragraph of this subsection, or subsequent to such a default, then, unless and until such default shall be cured, such trustee shall set apart and hold in a special account for the benefit of the trustee individually and the indenture security holders –

(1) an amount equal to any and all reductions in the amount due and owing upon any claim as such creditor in respect of principal or interest, effected after the beginning of such four months' period and valid as against such obligor and its other creditors, except any such reduction resulting from the receipt or disposition of any property described in paragraph (2) of this subsection, or from the exercise of any right of set-off which the trustee could have exercised if a petition in bankruptcy had been filed by or against such obligor upon the date of such default; and

(2) all property received in respect of any claim as such creditor, either as security therefor, or in satisfaction or composition thereof, or otherwise, after the beginning of such four months' period, or an amount equal to the proceeds of any such property, if disposed of, subject, however, to the rights, if any, of such obligor and its other creditors in such property or such proceeds.

Nothing herein contained shall affect the right of the indenture trustee –

(A) to retain for its own account (i) payments made on account of any such claim by any person (other than such obligor) who is liable thereon, and (ii) the proceeds of the

bona fide sale of any such claim by the trustee to a third person, and (iii) distributions made in cash, securities, or other property in respect of claims filed against such obligor in bankruptcy or receivership or in proceedings for reorganization pursuant to the Bankruptcy Act or applicable State law; . . .

(C) . . . As used in this paragraph, with respect to any claim, the term "dividends" shall include any distribution with respect to such claim, in bankruptcy or receivership or in proceedings for reorganization pursuant to the Bankruptcy Act or applicable State law, whether such distribution is made in cash, securities, or other property, but shall not include any such distribution with respect to the secured portion, if any, or such claim. The court in which such bankruptcy, receivership, or proceeding for reorganization is pending shall have jurisdiction (i) to apportion between the indenture trustee and the indenture security holders, in accordance with the provisions of this paragraph, the funds and property held in such special account and the proceeds thereof, or (ii) in lieu of such apportionment, in whole or in part, to give to the provisions of this paragraph due consideration in determining the fairness of the distributions to be made to the indenture trustee and the indenture security holders with respect to their respective claims, in which event it shall not be necessary to liquidate or to appraise the value of any securities or other property held in such special account or as security for any such claim, or to make a specific allocation of such distribution as between the secured and unsecured portions of such claims, or otherwise to apply the provisions of this paragraph as a mathematical formula. . . .

(b) The indenture to be qualified may contain provisions excluding from the operation of subsection (a) of this section a creditor relationship arising from – . . .

(3) disbursements made in the ordinary course of business in the capacity of trustee under an indenture, transfer agent, registrar, custodian, paying agent, fiscal agent or depositary, or other similar capacity;

(4) an indebtedness created as a result of services rendered. . . .

APPENDIX B

Trust Indenture Act of 1939, Section 317 (15 U.S.C. §77 qqq)

Special powers of trustee; duties of paying agents

(a) The indenture to be qualified shall contain provisions – . . .

(2) authorizing such trustee to file such proofs of claim and other papers or documents as may be necessary or advisable in order to have the claims of such trustee and of the indenture security holders allowed in any judicial proceedings relative to the obligor upon the indenture securities, its creditors, or its property.